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No. 78-288

In the Supreme Court of the United States

OCTOBER TERM, 1978

WALTER WENCKE, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A-5 to A-12) is reported at 577 F.2d 619. The findings of fact and conclusions of law of the district court (Pet. Supp. App. 2-39) are not reported.

JURISDICTION

The judgment of the court of appeals was entered on June 29, 1978. The petition for a writ of certio-

rari was filed on August 21, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the district court abused its discretion in entering default judgments against petitioners.
2. Whether the Securities and Exchange Commission is bound in the present proceeding by factual determinations made by a state court.
3. Whether the district court obtained jurisdiction over a corporation that was subject to a state receivership.
4. Whether the district court was precluded by 28 U.S.C. 2283 from enjoining a state proceeding.

STATEMENT

On July 22, 1976, the Securities and Exchange Commission filed a complaint in the United States District Court for the Southern District of California against 21 corporations, five persons associated with them, and four trusts, alleging numerous and serious violations of the antifraud, periodic reporting, and proxy provisions of the Securities Act of 1933, 15 U.S.C. 77q(a), and the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), 78m(a), 78m(d), 78n(a), 78n(c), 78n(f) and rules promulgated thereunder.

The Commission alleged a complex series of transactions that resulted in the looting of assets of a publicly-held corporation—Sun Fruit, Ltd. (Pet.

App. A-7; R. 1-42).[1] It asserted that petitioner Wencke was the controlling figure in the scheme (R. 3-4). The Commission sought to enjoin the defendants from further violations of the securities laws and to obtain appointment of a receiver for certain of the corporations; the receiver would conduct their affairs and assert their claims to assets improperly taken.

After a hearing, the district court determined that the Commission had made a prima facie case that the defendants were engaged in an illegal scheme to defraud, and issued a preliminary injunction[2] and ap-

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[1] "R." refers to the record in the court of appeals.

[2] The district court found that in 1971 Wencke acquired an insolvent private corporation, Federal Fruit. Wencke engineered a series of real estate transactions that caused the net worth of Federal Fruit to be "artificially inflated by approximately $950,000" (R. 1084). To conceal these real estate transactions, Wencke falsified the records of Federal Fruit (R. 1085). Thereafter, he gained control of Royal Executive Inns (subsequently renamed Sun Fruit), a publicly-held corporation, and caused it to acquire Federal Fruit at a price based on the artificially inflated earnings and net worth of the latter corporation (R. 1084-1086). Wencke did not reveal his beneficial interest in Federal Fruit or the artificial inflation of its net worth in either the current or annual reports of the publicly-held corporation filed with the Commission or a letter to the public shareholders of Sun Fruit (R. 1086). Wencke later transferred substantially all of the assets of the publicly-held corporation to shell corporations owned or controlled by him, in exchange for nominal cash and promissory notes from the acquiring corporations. Those corporations had no assets other than the hotels they acquired. Sun Fruit was not to receive any payments on the principal of the notes for 17 years (R. 1086-1090).

pointed a temporary receiver (R. 1099, 1102-1120).[3] The court did not include in its order the assets of Sun Fruit and its subsidiaries, which were subject to a state court receivership in Nevada. Wencke had petitioned for, and was the receiver in, the Nevada proceedings; Nevada does not require a disinterested receiver (Pet. App. A-7).[4]

The Commission then commenced discovery and attempted to depose Wencke. He refused to be sworn, however, even after the presiding magistrate directed him to appear and testify. After a hearing before the magistrate, at which it was ascertained that Wencke understood the consequences of his refusal to obey this order, the district court struck the defendants' answers and entered a default judgment against them (Pet. Supp. App. 7).

The district court deemed the allegations in the complaint to be admitted by the defendants, entered a permanent injunction and appointed a receiver.[5] It

[3] The individual defendants other than Wencke and his wife consented to entry of permanent injunctions without admitting or denying the allegations in the complaint (Pet. App. A-8).

[4] The Commission was not a party to, and never appeared in, that proceeding.

[5] The receiver was directed to marshal and conserve the assets and "prevent the withdrawal and misapplication of funds or assets," to investigate the conduct of past management, and to review all past filings with the Commission (Pet. Supp. App. 27-32).

The court also ordered Wencke to disgorge assets taken in violation of law or fiduciary duty and enjoined him from holding a position as an officer or director of any public corporation (Pet. Supp. App. 34, 36).

determined that it did have jurisdiction over Sun Fruit, despite the Nevada proceedings. Because Wencke was deemed to have admitted that the receivership was solely a device "to consummate and conceal his scheme to loot Sun Fruit" (Pet. Supp. App. 8), the court was at liberty to disregard considerations of comity with state courts. It ordered the Nevada court to turn over all assets of Sun Fruit to the federal receiver and to refrain from any further action in the state receivership (Pet. Supp. App. 38).[6]

The court of appeals affirmed. It held that Wencke's refusal to submit to discovery justified entry of a default judgment unless the Commission's complaint failed on its face to state a claim or the district court lacked jurisdiction even given the SEC's allegations. It rejected Wencke's challenge to the district court's jurisdiction, holding that the district court had jurisdiction over Sun Fruit despite the Nevada receivership proceedings, and that therefore petitioners' claim that an indispensable party had not been joined was wrong. The court of appeals concluded that Wencke could not rely on the receivership to prevent the federal court from taking jurisdiction over Sun Fruit because "Wencke * * * has unclean hands and may not resort to the Nevada receivership in a court of equity to insulate his fraud" (Pet. App. A-9). It also held that the Commission is not bound

[6] The Nevada court terminated the receivership, and the federally-appointed receiver now has control of Sun Fruit's assets (Pet. App. A-9).

by the orders entered in the Nevada proceeding, because the Commission had not appeared in it. Finally, it concluded that the district court was not barred by 28 U.S.C. 2283, which prohibits federal injunction of certain state court actions, from enjoining the Nevada court in this case.

ARGUMENT

1. Petitioners contend (Pet. 9-11) that the district court's order striking their answers and entering a default judgment against them was improper because Wencke's refusal to obey the discovery order was not willful, but rather was compelled by his inability to pay counsel to represent him during discovery.

It is difficult to understand why lack of counsel should be an excuse for refusal to take an oath at a deposition. The oath is required with or without counsel. But however that may be, in the district court Wencke argued not that he could not afford counsel but that he was disinclined to spend funds for this purpose (Pet. Supp. App. 7; Pet. App. A-8; R. 1168-1170). Accordingly, *Societe Internationale* v. *Rogers*, 357 U.S. 197 (1958), on which petitioners rely (Pet. 10), does not help their case. The Court there disapproved dismissal of a complaint for failure to comply with a discovery order "when it [was] established that failure to comply [was] due to *inability*, and not to willfulness * * *" (357 U.S. at

212) (emphasis added). Wencke was not *unable* to take an oath and answer questions.[7]

The record demonstrates willful refusal to comply with the discovery order. Wencke had counsel. They left no doubt that Wencke would not testify and clearly indicated to the magistrate that Wencke's object in refusing was to obtain resolution of the jurisdictional issue, and that he knew the defendants' answers might be stricken and a default judgment entered as a sanction for noncompliance (Pet. Supp. App. 7; R. 1168-1170).[8] As the court of appeals held, "he made the choice knowing the result," and the district court did not abuse its discretion in entering default judgments (Pet. App. A-8 to A-9). See *National Hockey League* v. *Metropolitan Hockey Club*, 427 U.S. 639 (1976).[9]

2. Petitioners contend (Pet. 12-14, 18-22) that the default judgment improperly avoids the collateral es-

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[7] Wencke is not a legal novice. He was a practicing lawyer until the mid-1960s (R. 3) and purports to represent the other petitioners as well as himself in this Court.

[8] There is no conflict with *Flaks* v. *Koegel*, 504 F.2d 702 (2d Cir. 1974), in which the Second Circuit required an evidentiary hearing prior to entry of a default judgment under Fed. R. Civ. P. 37. Wencke was accorded a hearing at which he fully set forth his reasons for failure to comply.

[9] Although the district court struck petitioners' pleadings as a sanction under Rule 37 without inquiring into the correctness of the Commission's allegations in its complaint, the court satisfied itself at least preliminarily about the merits of the Commission's allegations before entering the preliminary injunction. See page 3 and note 2, *supra*.

toppel effect of judgments entered in the Nevada receivership. They appear to contend that the Commission is bound by the determinations of the Nevada court which, they assert, hold that no fraud was committed by Wencke.

But the SEC was not a party in the Nevada case. Petitioners' assertion that the appearance by the California Corporation Commissioner in the Nevada proceeding binds the Commission because both represent the same "real parties in interest, the public investors in Sun Fruit" (Pet. 18-19), is, as the court of appeals put it, "nonsense" (Pet. App. A-10). The commissions enforce "different statutes enacted by different sovereigns" (*ibid.*). None of the authorities relied on by petitioners (Pet. 18-19) purports to hold the federal government estopped by a judgment in a case in which the federal government was not a party.

3. Petitioners argue (Pet. 14-15) that the decision of the court of appeals disregards the settled principle (*Porter* v. *Sabin*, 149 U.S. 473 (1893)) that a receiver appointed by a state court may not be sued, in his capacity as receiver, without the state court's consent, in the absence of a statute to the contrary. They argue that because the district court obtained jurisdiction over Sun Fruit by serving Wencke as an officer of the corporation, and because Wencke could not be sued in his capacity as receiver without the Nevada court's consent, the district court did not have jurisdiction over Sun Fruit. Petitioners conclude the argument by contending that the present litigation could not proceed in the absence of Sun Fruit because it is an indispensable party (Pet. 5-6).[10]

The purpose of the rule summarized in *Porter* is to prevent suits that can defeat a receivership by disposing of assets outside the receivership proceedings. *Barton* v. *Barbour*, 104 U.S. 126, 128-129 (1881). One court should have full authority over the assets. But because the district court held, on the basis of facts deemed to be admitted by petitioners, that the Nevada receivership "was simply a device to cover Wencke's fraud" (Pet. App. A-10), the normal solicitude for state receivership proceedings is not appropriate here. Cf. *Pennsylvania* v. *Williams*, 294 U.S. 176, 182-186 (1935) (suggesting that state statutory procedure for liquidation could be supplanted by federal receivership if state procedure was not "diligently and honestly followed"). In this case, federally protected interests were being threatened by admittedly sham proceedings, and the district court properly exercised its discretion to prevent further violations of the securities laws and to protect the public. See *Tcherepnin* v. *Kirby*, 416 F.2d 594

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[10] Sun Fruit did not appeal, and the propriety of asserting jurisdiction over Sun Fruit therefore could not be raised except by the indirect "indispensable party" argument (Pet. App. A-9). It is far from clear that Sun Fruit is an "indispensable party" to the case; there is no reason why a court is forbidden to enter an injunction against a securities laws violator simply because one of the controlled corporations is beyond the reach of the court. There is no need to pursue this line of argument, however, because for the reasons discussed in the text the district court had jurisdiction over Sun Fruit.

(7th Cir. 1969); *Intermountain Building & Loan Association* v. *Gallegos*, 78 F.2d 972 (9th Cir. 1935). Once the district court entered its injunction and appointed a federal receiver, moreover, any possibility of inconsistent orders concerning the same corporate assets vanished. It did not deal with the assets piecemeal but instead replaced one receiver with another.

4. Petitioners urge (Pet. 16-17) that 28 U.S.C. 2283 precluded the district court from enjoining the Nevada proceedings. But, as this Court has held, Section 2283 does not apply to injunctions issued at the request of the United States or federal agencies. *Leiter Minerals, Inc.* v. *United States*, 352 U.S. 220 (1957); *NLRB* v. *Nash-Finch Co.*, 404 U.S. 138 (1971). "The purpose of § 2283 was to avoid unseemly conflict between the state and the federal courts where the litigants were private persons, not to hamstring the Federal Government and its agencies in the use of federal courts to protect federal rights." *Nash-Finch*, *supra*, 404 U.S. at 146. Section 2283 thus does not apply to the injunctions at issue here.[11]

[11] The federal government was not involved in either of the cases relied on by petitioners, *Vendo Co.* v. *Lektro-Vend Corp.*, 433 U.S. 623 (1977) and *Vernitron Corp.* v. *Benjamin*, 440 F.2d 105 (2d Cir.), cert. denied, 402 U.S. 987 (1971).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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